IN THE

Supreme Court of the United States

OCTOBER TERM 1968

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No. [redacted] 42

HOWARD ROSS and BERNARD ROSS, as Trustees for LENA ROSENBAUM,

Petitioners,

—against—

ROBERT A. BERNHARD
HOWARD L. CLARK
CLARENCE FRANCIS
DONALD P. KIRCHER
PAUL E. MANHEIM
JOHN W. REAVIS
FRAZAR B. WILDE
MORRIS NATELSON
FRANK J. MANHEIM
MARCEL A. PALMARO
LUCIUS D. CLAY
FREDERICK L. EHRMAN
MONROE C. GUTMAN
ROBERT LEHMAN
PAUL M. MAZUR
ALVIN W. PEARSON
CHARLES B. THORNTON
JOSEPH A. THOMAS
H. J. SZOLD
HERMAN M. KAHN
EDWIN L. KENNEDY
ALLAN B. HUNTER
WILLIAM H. OSBORNE, JR.
and THE LEHMAN CORPORATION

Respondents,

and

PAUL L. DAVIES
JAMES K. HART
THOMAS A. MORGAN
T. S. PETERSEN
ARTHUR D. SCHULTE
ERNEST B. BREECH
JAMES M. HESTER
B. EARL PUCKETT

Defendants.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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No.

HOWARD ROSS and BERNARD ROSS, as Trustees for LENA ROSENBAUM,

Petitioners,

—against—

ROBERT A. BERNHARD, et al.,

Respondents,

and

PAUL L. DAVIES, et al.,

Defendants.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Howard Ross and Bernard Ross, as Trustees for Lena Rosenbaum, Plaintiffs-Appellees below, petition for a writ of certiorari to review the judgment of the Court of Appeals for the Second Circuit. The judgment is dated and was entered November 1, 1968 (App. 18-19).

Opinions Below

The opinion of the District Court for the Southern District of New York is reported at 275 F. Supp. 569. The opinion of the Second Circuit has not yet been reported (App. 4-17).

Jurisdiction

The District Court's jurisdiction was based upon the Investment Company Act of 1940, 15 U.S.C. §§ 80a-1, et seq. The jurisdiction of the Court of Appeals was based

on 28 U.S.C. § 1292(b), that Court having accepted a certification from the District Court. This Court's jurisdiction is based on 28 U.S.C. § 1254(1).

Question Presented

When a corporate action to recover money entitles all parties to a jury trial, is the jury right lost where the corporation is compelled to seek relief at the instance of a stockholder in a derivative action?

Constitutional Provisions and Statutes

Seventh Amendment to the Constitution:

> "In Suits at common law, where the value in controversy shall exceed twenty dollars, the right of trial by jury shall be preserved, and no fact tried by a jury, shall be otherwise re-examined in any Court of the United States, than according to the rules of the common law."

Section 44 of the Investment Company Act of 1940, 15 U.S.C. § 80a-43:

> "Sec. 44. The district courts of the United States and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have jurisdiction of violations of this title or the rules, regulations, or orders thereunder, and, concurrently with State and Territorial courts, of all suits in equity and actions at law brought to enforce any liability or duty created by, or to enjoin any violation of, this title or the rules, regulations, or orders thereunder. . . ."

Statement of the Case

This is an action brought by stockholders of The Lehman Corporation in its right and on its behalf. It is brought under the Investment Company Act of 1940, 15 USC § 80a-1, et seq. The amended complaint alleges that the Corporation, under the control of its broker, Lehman Brothers, has paid illegal and unnecessary brokerage commissions to Lehman Brothers. The plaintiffs made timely demand for a jury trial. Pre-trial discovery was completed, plaintiffs filed a note of issue and the action was placed upon the trial calendar. Defendants then moved to strike plaintiffs' demand for jury trial and to transfer the case to the non-jury calendar. The District Court denied defendants' motion, but certified the question to the Court of Appeals for the Second Circuit, which accepted the certification. The Second Circuit, in a two-to-one opinion, reversed the District Court.

Reasons for Granting the Writ

A. A conflict between the Second and Ninth Circuits on the issue of the right to a jury trial in stockholders' derivative cases requires resolution by this Court.

The Court of Appeals for the Second Circuit has held here that there is no right to a jury trial in a stockholder's derivative action to recover money damages. This decision is, acknowledgedly, in head-on collision with that of the Court of Appeals for the Ninth Circuit, which holds that a jury trial does lie in a stockholder's derivative action. (*DePinto* v. *Provident Security Life Insurance Co.*, 323 F.2d 826 (9 Cir. 1963), cert. den. 376 U.S. 950, reh. den. 383 U.S. 973).

Early resolution by this Court of the conflict between the circuits is necessary to prevent a confusion of conflicting adjudications throughout the country as well as a great loss of the time of District Courts and Courts of Appeals. There are presently pending, in the district courts encompassed by the Second and the Ninth Circuits and in other circuits around the country, a great many stockholder's derivative actions. In several of them the issue of the right to a jury trial is pending undetermined.*

Unless certiorari is granted here, the cases pending in the districts covered by the Second Circuit will proceed, as the present case must over the objection of plaintiffs, to lengthy trials without juries. If this court ultimately determines to follow the Ninth Circuit decision in *DePinto*, the parties in derivative cases in the Second Circuit will have been deprived of jury trials; all those cases may have to be retried, thus adding to the congestion of an already badly congested calendar. Similar problems will arise in the other circuits around the country which will, unless guided by the decision of this Court, have to choose between the opposite rules of the Ninth and Second Circuits. The grant of certiorari here is the only way to prevent a staggering waste of judicial time and litigants' money.

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* Thus, in the Southern District of New York, a random sampling indicates that juries have been demanded in the following stockholder's derivative cases: *Fogel* v. *Chestnutt*, 67 Civ. 60; *Fogel* v. *Chestnutt*, 68 Civ. 2885; *Saperstone* v. *Kapelow*, 67 Civ. 3262; *Waxman* v. *Youngman*, 65 Civ. 684; *Schwartz* v. *Starr*, 65 Civ. 735; *Gluck* v. *Bell*, 65 Civ. 693; *Polack* v. *Starr*, 65 Civ. 832; *Newman* v. *Stein*, 68 Civ. 1398; *Zeitlin* v. *Bergen*, 66 Civ. 4479; *Goodman* v. *von der Heyde*, 68 Civ. 973; and *Rittenberg* v. *Chalker*, 68 Civ. 438. In the Northern District of California, a jury has been demanded in *Norman* v. *McKee*, No. 23489.

B. The Court of Appeals decision of a fundamental constitutional question is in conflict with applicable decisions of this Court.

As the District Court here recognized, a stockholder's derivative action is constituted essentially of two parts. The first part concerns the shareholder's right to maintain the action on behalf of the corporation. This question, it may be conceded, is a matter of equity. The second part is the underlying claim of the corporation asserted in the action. This claim may be either legal or equitable depending upon its nature. *Koster* v. *Lumbermens Mutual Cas. Co.*, 330 U.S. 518, 522-23 (1947); *Meyer* v. *Fleming*, 327 U.S. 161, 168 (1946).

Prior to the union of law and equity, an equity court, once having taken jurisdiction, would proceed to final adjudication of all issues, legal and equitable, in the single suit in equity. The adoption of the Federal Rules of Civil Procedure in 1938 worked a historical change by merging law and equity into a single unified system. The artificial restraints of the old system were eliminated. It now became possible for a litigation to be tried before a single judge sitting at once as a law court trying the legal issues with a jury if demanded, and an equity court trying the equity issues.

The Court of Appeals below analyzed this case by utilizing pre-merger concepts: It noted that a derivative action, under the pre-unified system, would have had to be instituted in equity and an equity court would have decided the entire case without reference to a jury. Therefore, it held, no right to trial by jury is ever present in a stockholder's derivative action, even though the underlying corporate claim be legal rather than equitable.

This Court, however, rejected just such a test in *Beacon Theatres, Inc.* v. *Westover,* 359 U.S. 500 (1959). In that case, plaintiff sought an injunction and defendant counterclaimed for treble damages under the antitrust laws. This Court held that if legal claims were present, a jury was required; the blending of legal and equitable claims, which formerly would have resulted in equity jurisdiction, does not now destroy the right to a jury trial of the legal issues.

> " * * * 'Maintenance of the jury as a fact-finding body is of such importance and occupies so firm a place in our history and jurisprudence that any seeming curtailment of the right to a jury trial should be scrutinized with the utmost care.'
>
> " * * * Since in the federal courts equity has always acted only when legal remedies were inadequate, the expansion of adequate remedies provided by the Declaratory Judgment Act and the Federal Rules necessarily affects the scope of equity. Thus, the justification for equity's deciding legal issues once it obtains jurisdiction, and refusing to dismiss a case, merely because subsequently a legal remedy becomes available, must be re-evaluated in the light of the liberal joinder provisions of the Federal Rules which allow legal and equitable causes to be brought and resolved in one civil action." (359 U.S. at 501, 509)

In *Dairy Queen, Inc.* v. *Wood,* 369 U.S. 469 (1962), this Court emphatically reaffirmed its holding in *Beacon Theatres.* In *Dairy Queen,* the complaint alleged that the defendant was infringing the plaintiff's trademark and had breached a licensing agreement between the parties; it sought an injunction and an accounting. These were all, historically and traditionally, "equitable" claims—just as

the stockholder's derivative action is traditionally "equitable". Nonetheless, this Court held that, since money recovery was also sought, the right to jury trial is not destroyed. The Court stated:

> "The holding in Beacon Theatres was that where both legal and equitable issues are presented in a single case, 'only under the most imperative circumstances, circumstances which in view of the flexible procedures of the Federal Rules we cannot now anticipate, can the right to a jury trial of legal issues be lost through prior determination of equitable claims.'[7] That holding, of course, applies whether the trial judge chooses to characterize the legal issues presented as 'incidental' to equitable issues or not.[8] Consequently, in a case such as this where there cannot even be a contention of such 'imperative circumstances', Beacon Theatres requires that any legal issues for which a trial by jury is timely and properly demanded be submitted to a jury. There being no question of the timeliness or correctness of the demand involved here, the sole question which we must decide is whether the action now pending before the District Court contains legal issues." (369 U.S. at 472-73)

"7. Id. 359 U.S. at 510, 511.

8. 'It is therefore immaterial that the case at bar contains a stronger basis for equitable relief than was present in Beacon Theatres. It would make no difference if the equitable cause clearly outweighed the legal cause so that the basic issue of the case taken as a whole is equitable. As long as any legal cause is involved the jury rights it creates control. This is the teaching of Beacon Theatres, as we construe it.' Thermo-Stitch, Inc. v. Chemi-Cord Processing Corp. (CA5 Fla.) 294 F.2d 486, 491."

In the present case the Court of Appeals denied the right to a jury because "the assertion of any 'legal' claim on behalf of the corporation is totally *dependent* upon plain-

tiffs' successfully establishing their capacity to sue at equity. Thus, in applying the Seventh Amendment the two portions of the complaint cannot be regarded as separable and divisible." (App. 14) (emphasis supplied).

But this effort to distinguish this court's holdings in *Beacon Theatres* and in *Dairy Queen* does not withstand analysis. For the holding of these cases is that, where both legal and equitable issues are presented in a single case, the right to a jury trial must not be lost by the way in which "the trial judge chooses to characterize the legal issues" (*Dairy Queen, supra,* 369 U.S. at 473). In *Dairy Queen,* the trial court denied a jury, denigrating the legal issue by characterizing it as merely "incidental" to the equitable issue (369 U.S. 469, 470). In the present case, the Court of Appeals rationalizes denial of a jury by referring to the legal issue as "dependent" on the equitable issues. However the legal issue be labeled, it is unquestioned that there *is* a legal issue here. And this court has laid down the rules in terms so broad as to reject semantic erosion: "only under the most imperative circumstances . . . can the right to a jury trial of legal issues be lost through prior determination of equitable claims" *Beacon Theatres, supra* (359 U.S. at 510-511). If indeed the right to a jury trial should depend on such elusive and unfunctional a concept as would require balancing the weight of the equity claim against that of the law claim, it is nevertheless plain that the dominant claim in most derivative cases is the underlying corporate claim. The fact that equity has fashioned a remedy which enables any shareholder of a corporation, immobilized by recreant directors, to rescue the corporation and bring it to the Courthouse should not deprive the corporation or, for that matter, the defendants, of their right to a jury trial.

Thus, this Court has recognized that the important issue in stockholders' derivative actions is not the equitable question of whether the particular stockholder is entitled to maintain the action but, rather, the underlying substantive legal claim against the defendants. "The cause of action which such a [derivative] plaintiff brings before the Court is not his own but the Corporation's. It is the real party in interest and he is allowed to act in protection of its interest somewhat as a 'next friend' might do for an individual, because it is disabled from protecting itself"; *Koster* v. *Lumbermens Mutual Cas. Co.*, 330 U.S. 518, 522-3 (1947). "The fact that [in a stockholder's derivative action] the corporation is nominally a defendant * * * gives the suit only a difference in form, not a difference in substance"; *Meyer* v. *Fleming*, 327 U.S. 161, 168 (1946).

C. The Ninth Circuit decision in DePinto is consonant with the decisions of this Court.

1. *The right to jury trial in a derivative stockholders' action.*

The exact issue passed upon by the Court of Appeals was decided in 1963 by the Ninth Circuit in *DePinto* v. *Provident Security Life Insurance Co.*, 323 F. 2d 826 (9 Cir. 1963), cert. den. 376 U.S. 950, reh. den. 383 U.S. 973. In *DePinto*, the Court held that the right to a jury trial must be preserved in a stockholder's derivative action where such right would have existed had the suit been brought by the corporation in the first instance. The Court stated:

> "Thus, except under most imperative circumstances, a right to a jury trial on legal issues may not now be denied to a federal litigant on the ground that the case reached court only through equity, or because equitable rights are involved, or because the

legal issues are 'incidental' to the equitable issues, or because substantive equitable remedies are sought, or by the device of trying the equitable issues first.

"A stockholder's derivative action is an invention of equity to supply the want of an adequate remedy at law to redress breaches of fiduciary duty. Koster v. Lumbermens Mutual Casual Co., 330 U.S. 518, 522, 67 S. Ct. 828, 91 L. Ed. 1067. The aid of equity is needed in order to establish the shareholder's right to sue in the corporate stead. Fanchon & Marco, Inc. v. Paramount Pictures, Inc., 2 Cir., 202 F. 2d 731, 734, 36 A.L.R. 2d 1336. But the claim set up is that of the corporation.

"In order to determine whether appellants were entitled to a jury trial in this derivative action, it is therefore necessary to ascertain whether any of the claims asserted against them on behalf of the corporation are of a kind which, if asserted by the corporation, would be cognizable in a suit at common law. If so, and if the judgment which has been entered, insofar as can be determined rests on claims of that kind, there has been a denial of trial by jury as guaranteed by the Seventh Amendment and appellants have been aggrieved thereby." (323 F. 2d at 836-37)

The Court of Appeals below made no attempt to distinguish *DePinto*. It merely commented that the Ninth Circuit's decision was not "persuasive". (App. 8).*

* The sole federal judicial authority which the majority of the panel below was able to cite for the proposition that there is no right to jury trial in a derivative action is the District Court decision in *Richland* v. *Crandall*, 259 F. Supp. 274 (SDNY 1966). The Court's statement in *Richland* that there is no right to a jury trial in a derivative stockholder's action was academic since the court allowed a jury, the case was tried to a jury and the Court adopted the jury's findings. See *Richland* v. *Crandall*, 262 F. Supp. 538, 543 (SDNY 1967).

2. The nature of the underlying claim.

In the present case the District Court found—and the Court of Appeals did not challenge that finding—that the underlying claim of the corporation involves legal causes of action. The complaint, in brief, attacks the commissions received from the corporation by its broker. The defendants are charged with negligence, violations of the Investment Company Act and conversion of the corporation's assets. These causes of action are all cognizable at common law. 5 Moore, *Federal Practice*, ¶. 38.11[5] (2d Ed. 1967); *Simler* v. *Conner*, 372 U.S. 221 (1963); *Schultz* v. *Manufacturers & Traders Trust Co.*, 128 F. 2d 889 (2 Cir. 1942), cert. den. 317 U.S. 674; *Restatement of Agency*, 2d, §§ 399 *et seq.*

The Court of Appeals for the Third Circuit held in *Kelly* v. *Dolan*, 233 Fed. 635, 637 (3 Cir. 1916):

> "That the negligence of a director is an injury to his corporation, and that the right to recover for such negligence is a legal as contrasted with an equitable right, and that the corporation is vested with the right to recover for such injury, is established by authority. In some cases, this right is asserted in equity; in some at law, according to circumstances; but in whatever form it is litigated the right to recover for negligence is a legal right."

In *DePinto* the Ninth Circuit held:

> "Having in mind the necessity of scrutinizing, with utmost care, any seeming curtailment of the right to a jury trial, we hold that where a claim of breach of fiduciary duty is predicated upon underlying conduct, such as negligence, which is actionable in a direct suit at common law, the issue of whether there has been such a breach is, subject to appropriate instruc-

> tions, a jury question. We therefore conclude that, in the context of this case, the question concerning breach of fiduciary duty, as well as negligence, should have been submitted to the jury. * * *" (*DePinto* v. *Provident Security Life Insurance Co.*, 323 F. 2d 826, 837 (9 Cir. 1963), cert. den. 376 U.S. 950, reh. den. 383 U.S. 973.)

See also *Halladay* v. *Verschoor*, 381 F. 2d 100, 109 (8 Cir. 1967).

That the prayer for relief in the complaint asks that the defendants be required to "account for and pay to the Corporation for their profits and gains and its losses", does not alter the nature of the claim. As this Court stated in *Dairy Queen*:

> "The respondents' contention that this money claim is 'purely equitable' is based primarily upon the fact that their complaint is cast in terms of an 'accounting;' rather than in terms of an action for 'debt' or 'damages'. But the constitutional right to trial by jury cannot be made to depend upon the choice of words used in the pleadings. . . . The legal remedy cannot be characterized as inadequate merely because the measure of damages may necessitate a look into petitioner's business records." (369 US at 477-79).

D. The decision of the Court of Appeals is in conflict with a prior decision of a different panel of the same Court.

In Fanchon & Marco, Inc. v. *Paramount Pictures, Inc.*, 202 F. 2d 731 (2 Cir. 1953), the Court of Appeals held that in a derivative action where the underlying cause of action charges violation of the antitrust laws, there is a right to a jury trial which is not destroyed by the fact that the action may be brought derivatively:

> " . . . The two major issues of right of the shareholder to sue and of violation of the antitrust laws causing damage of the corporation can be tried side by side or otherwise as may be convenient; that one may go to the jury while the other does not causes no difficulty." (202 F. 2d at 735)

The Court of Appeals here thought that that prior holding was dictum. Clearly, it was not. The defendants had successfuly obtained dismissal of the action by the District Court. They argued that they were entitled to a jury trial and that under the rationale of *Fleitmann* v. *Welsbach Street Lighting Co.*, 240 U.S. 27 (1916), decided prior to the merger of law and equity, a jury trial was not available in a derivative stockholders' action. This, it was urged, required dismissal of the action. The Court of Appeals in *Fanchon* held, however, that the *Fleitmann* rationale did not apply to a merged system of law and equity and that the derivative action could be maintained while still preserving defendants' right to a jury trial.

The Court of Appeals here sought to distinguish *Fanchon* in that the underlying claim there was for treble damages under the antitrust laws. Thus, said the Court of Appeals, the jury trial right was statutory in *Fanchon* whereas here it is constitutional. This attempt at distinction misses the mark. In the first place, the right to a jury in an antitrust action is not provided by the statute but results from the fact that—as in the present case—a money judgment for damages may result. If the availability of such a judgment means that the statute contemplates a jury trial, then it must be said that § 44 of the Investment Company Act, 15 USC § 80a-43, which authorizes actions at law to enforce liabilities created by the act, similarly

confers a jury right.* More importantly, however, it is difficult to see how a statutorily created right relating to the underlying cause of action could achieve greater sanctity than a similar constitutionally provided one. In short, the *Fanchon* case cannot be distinguished; and the conflict of panels in the Second Circuit is a further reason calling for resolution by this Court. *Dickinson* v. *Petroleum Conversion Corp.*, 338 U.S. 507, 508 (1950); *John Hancock Mutual Life Ins. Co.* v. *Bartels*, 308 U.S. 180, 181 (1939).

If the Court of Appeals' overruling of *Fanchon* is permitted to stand, then the Second Circuit will be thrown back to the pre-1938 rule of *Fleitmann*. The consequence would be that defendants, sued for damages for violation of federal statutes, will be able to procure dismissal of derivative stockholders' actions simply by insisting on their rights to trial by jury. Thus would be lost "a most effective weapon in the enforcement" of federal legislation. *J. I. Case* v. *Borak*, 377 U.S. 426, 432 (1964).

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* Contrary to the suggestion made by the Court of Appeals, (App. 12, n. 1), the contention that the Investment Company Act authorizes actions at law which involve jury rights was pressed both in the District Court and in the Court of Appeals.

CONCLUSION

The decision of the Court of Appeals is in conflict with decisions of this Court, Courts of Appeal of other circuits, and prior panels of the Second Circuit. The decision is a denial of a fundamental constitutional right. If permitted to stand it would have grave consequences not only for the constitutional right of trial by jury. It would also lead to immunization of violators of federal statutes from redress in derivative stockholder's action.

For the foregoing reasons, this petition for a writ of certiorari should be granted.

Respectfully submitted,

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APPENDIX

Opinion of the District Court

Ross v. Bernhard, et al., 65 Civ. 665
Civ. Mot. Cal. Aug. 29, 1967 No. 69

This is a stockholders' derivative action by stockholders of The Lehman Corporation against directors of that corporation and against Lehman Brothers, the corporation's broker.* The complaint charges in substance that The Lehman Corporation has paid to Lehman Brothers brokerage commissions which are excessive for a variety of reasons and that the assets of The Lehman Corporation have thereby been wasted. This is said to be a violation of the Investment Company Act of 1940 (15 U.S.C. § 80a-1 *et seq.*). Defendants Clark, Francis, Kircher, Puckett, Reavis, Thornton, and Wilde move to strike plaintiffs' demand for a jury trial.

Whether or not plaintiffs are entitled to a jury trial depends upon the answer to two questions:

(1) Does the fact that this is a stockholders' derivative action, a creature of equity, in and of itself deprive plaintiffs of a trial by jury?

(2) If not, and if the question of a jury trial is to be viewed as though the corporation were suing, is the action a "suit at common law" within the meaning of the Seventh Amendment?

As to the first question, opposite conclusions were reached in *Richland* v. *Crandall*, 259 F. Supp. 274 (S.D.N.Y. 1966),

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* The complaint alleges that plaintiffs also sue representatively on behalf of themselves and of other stockholders of The Lehman Corporation similarly situated. Both sides agree, however, that this action is actually purely derivative, as the only relief sought is for the benefit of The Lehman Corporation. Consequently, the representative allegation has no bearing upon the issues raised by this motion.

and *DePinto* v. *Provident Security Life Insurance Company*, 323 F. 2d 826 (9th Cir. 1963), *cert. denied*, 376 U.S. 950 (1964). In my opinion the *DePinto* view is the correct one. The court there held that although the aid of equity is needed in order to establish the stockholders' right to sue on behalf of the corporation, the claim is that of the corporation and the right to a jury trial is to be judged as though the corporation were suing. This decision gives effect to *Fleitmann* v. *Welsbach Street Lighting Co.*, 240 U.S. 27 (1916), and *Fanchon & Marco, Inc.* v. *Paramount Pictures, Inc.*, 202 F. 2d 731 (2d Cir. 1953), in which this result was reached in antitrust treble damage actions. I see no reason why this rule should be peculiar to antitrust litigation. I will follow it here.

As to the second question, the allegations of the complaint are controlling. The complaint uses a number of harsh words. It charges that defendants have been guilty of "gross abuse of trust, gross misconduct, willful misfeasance, bad faith, gross negligence and a reckless disregard of their fiduciary duties." The prayer is for a judgment "requiring the defendants jointly and severally to account for and pay to the Corporation for their profits and gains and its losses."

The fact that plaintiffs seek an accounting, a word which smacks of equity, is not determinative.

Dairy Queen, Inc. v. Wood, 369 U.S. 469 (1962)

Plaintiffs are seeking a money judgment. They ask that defendants "pay" to the corporation defendants' gains and the corporation's loss. The issues are not so complicated

as to make it impracticable for a jury to ascertain the amount, if any, to which plaintiffs may be entitled.

It is true that the complaint employs equitable language in alleging that defendant directors have abused their trust and have disregarded their fiduciary duties. But the alleged facts which underlie these conclusions are simply that defendants have caused the corporation to pay out money which the corporation should not have paid, and that in consequence, the corporation is entitled to judgment for those moneys. This diversion of funds is alleged to be a conversion by defendants of the corporate assets. Whatever the law may formerly have been, I am persuaded that recent decisions of the Supreme Court, which have gone far in protecting the right to a jury trial under the Seventh Amendment, require the conclusion that this complaint states on behalf of the corporation a claim which is fundamentally legal rather than equitable.

Dairy Queen, Inc. v. *Wood, supra;*
Beacon Theatres, Inc. v. *Westover*, 359 U.S. 500 (1959);
See also DePinto v. *Provident Security Life Insurance Company, supra.*

Defendants' motion is denied.

So ordered.

Dated: November 3, 1967

EDWARD C. McLEAN
U.S.D.J.

Opinion of the Court of Appeals

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 6—September Term, 1968

(Argued September 5, 1968 Decided November 1, 1968.)

Docket No. 32118

HOWARD ROSS and BERNARD ROSS, as Trustees for LENA ROSENBAUM,

Plaintiffs-Appellees,

—v.—

ROBERT A. BERNHARD, *et al.*,

Defendants-Appellants.

Before:

LUMBARD, *Chief Judge,*
SMITH and ANDERSON, *Circuit Judges.*

Appeal from an order entered December 6, 1967 by McLean, *J.*, United States District Court for the Southern District of New York, denying defendants' motion to strike plaintiffs' demand for a jury trial, on the ground that the Seventh Amendment to the United States Constitution extends the right to a jury trial to stockholders' derivative actions.

Order reversed and cause remanded.

ROSENTHAL & GURKIN, New York, N. Y. (Pomerantz Levy Haudek & Block, New York, N. Y., Abraham L. Pomerantz and Richard M. Meyer, on the brief), *for Plaintiffs-Appellees.*

SULLIVAN & CROMWELL, New York, N. Y. (Marvin Schwartz and Cornelius B. Prior, Jr., on the brief), *for Defendants-Appellants, Clark, Francis, Kircher, Puckett, Reavis, Thornton and Wilde.*

SIMPSON THACHER & BARTLETT, New York, N. Y. (William J. Manning and Lawrence M. Mc Kenna, on the brief), *for Defendants-Appellants, Robert A. Bernhard, et al.*

WALSH & FRISCH, New York, N. Y. (E. Roger Frisch, on the brief), *for Defendant-Appellant, The Lehman Corporation.*

LUMBARD, *Chief Judge*:

This appeal, taken by permission, questions a district court ruling which would allow a jury trial of a stockholders' derivative action. The defendants in this diversity action appeal from a Southern District order entered November 6, 1967 denying their motion to strike plaintiffs' demand for a jury trial. On December 6, 1967, Judge McLean granted defendants' motion to resettle his order, finding that it involved "a controlling question of law as to which there is substantial ground for difference of opinion and that an immediate appeal from this order may

materially advance the ultimate termination of this litigation." As there is a difference of views in the district court on this question, see *Richland* v. *Crandall*, 259 F. Supp. 274 (S. D. N. Y. 1966), we thereafter permitted an interlocutory appeal to be taken pursuant to 28 U. S. C. §1292(b).

We hold that the right to a jury trial guaranteed by the Seventh Amendment to the United States Constitution does not extend to stockholders' derivative actions. Accordingly, we reverse the order of the district court.

This derivative action was brought under the Investment Company Act of 1940, 15 U. S. C. §§80a-1, et seq. Named as defendants are the Lehman Corporation, the investment company for whose benefit the suit is brought, various directors and officers of the corporation, and various partners of Lehman Brothers, an investment banking firm which acts as the investment advisor and principal broker for the corporation. Plaintiffs, stockholders of the Lehman Corporation, pray for a judgment requiring defendants to account for, and pay to the corporation, their profits and gains and its losses resulting from illegal and excessive brokerage commissions paid to Lehman Brothers. These commissions fall in three categories:

> 1) Commissions paid for carrying out transactions for the corporation on the New York Stock Exchange, despite the fact that these transactions could have been executed on the so-called "Third Market" at favorable net prices without the payment of any commissions, or executed other than on a national securities exchange with the payment of substantially smaller commissions than were paid to Lehman Brothers.

2) Commissions paid in connection with over-the-counter transactions in unlisted stocks, despite the fact that the corporation could have conducted these transactions directly with "market makers" and thus avoided paying any commissions.

3) "Reciprocal brokerage commissions" paid by the corporation for allocation to the brokers who provide investment advice to Lehman Brothers, which commissions constitute excessive compensation to Lehman Brothers under its investment advisory contract with the corporation.

The complaint further alleges that more than half of the corporation's directors are affiliated with Lehman Brothers, in violation of §10(b)(1) of the Investment Company Act, 15 U. S. C. §80a-10(b)(1). The payments are alleged to constitute "an unlawful and willful conversion" by defendant partners of Lehman Brothers of the corporation's assets, and "gross abuse of trust, gross misconduct, willful misfeasance, bad faith, gross negligence and a reckless disregard of their fiduciary duties" by the defendant officers, directors and brokers of the corporation.

The Seventh Amendment provides:

> In Suits at common law, where the value in controversy shall exceed twenty dollars, the right of trial by jury shall be preserved, and no fact tried by a jury, shall be otherwise reexamined in any Court of the United States, than according to the rules of the common law.

Judge McLean held that the question of whether the Seventh Amendment required this action to be tried before a jury, upon plaintiffs' demand, depended upon the nature of the corporate claim asserted derivatively by the stockholders; the Seventh Amendment was to be applied as if the corporation itself were suing. He further found that the corporate claim in this action was legal, rather than equitable, in character, being in essence a demand for a money judgment to recover the funds of the corporation converted by defendants. Thus the right to a jury trial attached to this derivative action.

Our disagreement with the court below stems from the teaching of history that the stockholder's derivative action has always been regarded as exclusively a creature of equity to which the right to a jury trial does not apply. The one previous dissent from this view, *DePinto* v. *Provident Security Life Ins. Co.*, 323 F. 2d 826 (9th Cir. 1963), *cert. denied* 376 U. S. 950 (1964), we do not find persuasive. Because of our view of the jury trial issue we have no occasion to address the question of whether the underlying corporate claim is legal or equitable in character.

In determining whether the constitutional right to a jury trial applies to a given action, the basic inquiry to be made is an historical one: At the time the Seventh Amendment was adopted was the action recognized as a "suit at Common law," as to which the right to a jury trial was to be "preserved." *Baltimore & C. Line* v. *Redman*, 295 U. S. 654, 657 (1935). Despite the merger of law and equity accomplished by the Federal Rules of Civil Procedure the right to a jury trial still applies only to actions which historically could have been brought at law. Rule 38(a), Fed.

R. Civ. P., preserves the right to a jury trial "as declared by the Seventh Amendment to the Constitution . . ." While the Supreme Court seems to have modified this historical test somewhat to take account of the procedural reforms effectuated by the Federal Rules, *Beacon Theatres* v. *Westover*, 359 U. S. 500, 508-11 (1959), for reasons stated below we do not believe that this modification affects the outcome of this case.

The authorities are agreed that the stockholders' derivative action did not evolve until well after the adoption of the Seventh Amendment in 1791. *See*, e.g., Prunty, *The Shareholders' Derivative Suit: Notes on Its Derivation*, 32 N. Y. U. L. Rev. 980, 981, 986 (1957). This fact does not, as defendants suggest, foreclose the possibility that derivative actions fall within the scope of the Seventh Amendment. In instances where either Congress or the courts have evolved a new remedy subsequent to the adoption of the Amendment it is to be analogized to its nearest historical counterpart, at law or equity, for the purposes of determining whether a right to jury trial exists. *See* 5 Moore, Federal Practice ¶38.11[7], at 125 (2nd ed. 1968); James, *Right to a Jury Trial in Civil Actions*, 72 Yale L. J. 654, 655 (1963). No tortuous process of historical analogy is required in this case, however, for it is clear that the derivative action was an invention of equity.

At law stockholders could not bring a suit in the corporation's name for the vindication of a corporate right because, apparently, such legal standing was regarded as incompatible with the limited liability for the corporation's debts enjoyed at law by the stockholders. Note, *The Right to a Jury Trial in a Stockholder's Derivative Action*, 74

Yale L. J. 725, 729 (1965). Beginning early in the Nineteenth Century equity began to recognize the derivative action, initially in order to provide a remedy against alleged wrongdoers to the corporation who also controlled its management and consequently refused to allow a suit by the corporation against themselves. *Taylor* v. *Miami Exporting Co.*, 5 Ohio 162 (1831); *Robinson* v. *Smith*, 3 Paige Ch. *222, *233 (N. Y. 1832) (dictum); *see* generally *Koster* v. *Lumbermens Mut. Co.*, 330 U. S. 518, 522 (1947). The remedy soon was extended to instances where the stockholders were seeking to enforce a corporate right against an outsider. *Dodge* v. *Woolsey*, 59 U. S. (18 How.) 331, 341-44 (1855); cf. *Forbes* v. *Whitlock*, 3 Ed. Ch. 446 (N. Y. 1841).

From these early suits to the present day the equitable nature of the derivative action has not been disputed. See *Dodge* v. *Woolsey*, 59 U. S. (18 How.) 331, 341 (1855); *Cohen* v. *Beneficial Loan Corp.*, 337 U. S. 541, 548 (1949). Likewise, with the sole exception of the *DePinto* decision, *supra*, there has been no significant dissent from the conclusion that the equitable nature of the action excludes it from the purview of the Seventh Amendment's jury trial guarantee. E.g., *Richland* v. *Crandall*, 259 F. Supp. 274 (S. D. N. Y. 1966); 5 Moore, Federal Practice ¶38.38[4], at 305-06 (2nd ed. 1968); 2 Hornstein, Corporation Law and Practice, ¶730 (1959); 13 Fletcher, Private Corporations, §5931 (Rev. ed. 1961); Note, *The Right to a Jury Trial in a Stockholder's Derivative Action*, 74 Yale L. J. 725, 732 n. 35 (1965) (citations to state court decisions under constitutional provisions similar to Seventh Amendment).

The court below, despite this impressive authority against the right to jury trial in derivative actions, reached a contrary result. It pointed out that a derivative action is composed of two distinct claims: 1) the stockholders' claim against the corporation for its refusal to sue in its own name, and 2) the underlying claim put forward for the corporation's benefit. The court held that while it must rule on the equitable issue of the stockholders' right to sue in the corporation's stead, there is no reason to refuse a demand for a jury trial on the underlying corporate claim if it is legal in character.

Other than the *DePinto* case the only supporting authorities cited by the court for its conclusion are *Fleitman* v. *Welsbach Street Lighting Co.*, 240 U. S. 27 (1916), and *Fanchon & Marco, Inc.* v. *Paramount Pictures, Inc.*, 202 F. 2d 731 (2d Cir. 1953). Both suits concerned derivative suits seeking treble damages under the Sherman Act. In the brief *Fleitman* opinion by Justice Holmes the court held that a derivative action would not lie, and for a reason which provides analogous support for defendants in this case. Justice Holmes pointed out that there could be no right to a jury trial in the equitable derivative action. Since he read the Sherman Act as requiring that treble damage actions be tried before a jury the Justice concluded that the derivative action could not be maintained.

Judge Clark's opinion in *Fanchon & Marco* did hint, entirely as dictum, that a jury trial could be demanded by a stockholder suing derivatively for treble damages. Since the jury trial issue does not appear to have been directly presented to the court we do not regard *Fanchon & Marco* as persuasive authority on this point. Moreover, whatever

was said in that opinion relates only to the *statutory* right to jury trial created by the Sherman Act, a fact made clear by the court's reliance on *Fleitman*. We deal here with the constitutional right to a jury trial. The accommodation suggested in *Fanchon & Marco* between the Sherman Act's requirement of a jury trial and the equitable nature of derivative actions is not relevant to our case, where no statutory right exists.[1]

On appeal plaintiffs urge the relevance of two Supreme Court cases construing the Seventh Amendment, *Beacon Theatres, Inc.* v. *Westover*, 359 U. S. 500 (1959), and *Dairy Queen, Inc.* v. *Wood*, 369 U. S. 469 (1962). Neither case is in point.

In *Beacon Theatres* the plaintiff, a theatre operator, alleged that he was being damaged by defendant's threat to file a treble damage action under the antitrust laws challenging the legality of plaintiff's exclusive "first run" contracts with motion picture distributors. Plaintiff sought an injunction against the threatened suit and a declaration that the contracts did not violate the antitrust laws. Defendant counterclaimed for treble damages on the ground that the contracts were illegal.

The Supreme Court noted that both the plaintiff's suit and the defendant's counterclaim revolved around the exact same issue: Were plaintiff's contracts in violation of the antitrust laws? The question, then, was whether plaintiff, by bringing a declaratory action for injunctive relief before

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[1] Plaintiffs on appeal make a fleeting argument in their brief that the Investment Company Act should be read as creating a statutory right to a jury trial. Brief for plaintiffs, p. 5. This question was not raised in the court below; and the record before us is not sufficient to enable this court to address the issue.

defendant could bring his law action for treble damages, thereby could deprive defendant of his right to have the antitrust issue tried before a jury. It was no surprise that the court said no; the common issue on which both the equitable and legal relief depended must be tried on the law side in order that the right to jury trial not be defeated altogether. *See* 359 U. S. at 504; James, *Right to a Jury Trial in Civil Actions,* 72 Yale L. J. 655, 687-90 (1963).

We have no such "race to the courthouse" situation in our case. Plaintiffs have lost no right to a jury trial they would have possessed had this issue been litigated at law; were it not for equity, plaintiffs would not be in court at all. In *Beacon Theatres* equity was invoked only to anticipate and defeat the assertion of a legal claim. Here equity grants to plaintiffs their capacity to sue, not merely an alternative form of relief. It is from the fountainhead of equity that this entire litigation flows, and we see no justification for artificially dividing the suit into two parts for the purposes of applying the Seventh Amendment. *See,* Note, *The Right to a Jury Trial in a Stockholder's Derivative Action,* 74 Yale L. J. 725, 729-32 (1965).

In *Dairy Queen, Inc.* v. *Wood,* 369 U. S. 469 (1962), the plaintiff sued for trademark infringement and sought both an accounting, which the Court viewed as a claim essentially legal in character, and an injunction. Once again the Court was confronted by two claims for relief which turned on the same issue. If the claim for an injunction were tried first the principle of collateral estoppel would bar a second trial, before a jury, on the legal claim for damages. In these circumstances the court held that the right to a jury trial could not be defeated by labeling the

legal claim "incidental" to the equitable claim and trying the latter claim first; rather the jury trial on the issue of damages must be given priority.

Unlike *Dairy Queen,* the complaint in this case does not merely join two claims which could have been presented in separate suits. Rather, the assertion of any "legal" claim on behalf of the corporation is totally dependent upon plaintiffs' successfully establishing their capacity to sue at equity. Thus in applying the Seventh Amendment the two portions of the complaint cannot be regarded as separable and divisible. Cf. *Robine* v. *Ryan,* 310 F. 2d 797, 798 (2d Cir. 1962).

The Supreme Court in *Beacon Theatres* and *Dairy Queen* did modify the historical test for applying the Seventh Amendment in one respect. The court noted that a prerequisite for equity jurisdiction has always been that no adequate remedy at law exists. One application of this rule concerned the "clean-up" power of an equity court; for the convenience of the parties, and to protect rights which might be jeopardized through the delay which would be caused by requiring an additional suit at law, equity courts whose jurisdiction had been properly invoked by an equitable claim would also dispose of related legal issues. This procedure, which operated to deny a jury trial of those related legal issues, is no longer justified in light of the liberal joinder provisions of the Federal Rules of Civil Procedure. Under the Rules a judge can have the legal issues tried first before a jury, and then immediately decide the equitable issues himself. There is no danger of jeopardizing rights through delay. Thus the court has held that the scope of equitable jurisdiction has declined

pro tanto as the adequacy of legal relief has increased through the procedural reforms of the Federal Rules. *Beacon Theatres, Inc.* v. *Westover*, 359 U. S. 500, 509 (1959).

This modification of the Seventh Amendment standard does not affect the determination of this case. Equity courts have not exercised jurisdiction over the underlying corporate claims in derivative suits pursuant to their clean-up power, but rather because law has never recognized suits brought by stockholders for their corporation's benefit. The derivative action analytically may be composed of two parts, but before the courts it has always been treated as one, unitary action brought at equity. *See* Note, *The Right to a Jury Trial in a Stockholder's Derivative Action*, 74 Yale L. J. 725, 729-32 (1965).

It is argued that refusing to extend the right to jury trial to derivative actions will cause anomalous results in cases where it is the defendant who demands a jury trial. The plaintiffs point out that while such a defendant would be entitled to a jury trial if the corporation itself brings a legal claim against him, he is, in plaintiffs' words, "cheated out" of his jury if the action is brought derivatively by the stockholders. But if a corporation and its stockholders conspire to have a claim brought derivatively, rather than by the corporation, for the purpose of depriving defendant of a jury trial, his rights can be protected by a remedy less severe than a far-reaching extension of the Seventh Amendment. The refusal of a corporation to sue in its own name in order to avoid a jury trial would violate the spirit of Rule 23.1, Fed. R. Civ. P., and there would be no basis for invoking the jurisdiction of equity to hear a derivative action. Of course no danger of collusion is present in

this case since all defendants are resisting plaintiffs' attempt to secure a jury trial.

As for the anomaly plaintiffs claim to perceive arising from the denial of a jury trial, it has existed since the very origin of the derivative action. We are aware of no great agitation among potential litigants or the bar concerning the traditional rule against jury trials in derivative actions.

It may well be that juries, perhaps with the aid of a master, see *Dairy Queen, Inc.* v. *Wood*, 369 U. S. 469, 478 (1963), are perfectly competent to try derivative actions, although we entertain some doubt on this point because of the exceedingly complex nature of many of these actions. But the Seventh Amendment does not ask that we assess the suitability of a given type of litigation for jury trial. In addition to invoking a judicially unmanageable standard, *see* James, *Right to a Jury Trial in Civil Actions*, 72 Yale L. J. 655, 690-91 (1963), such an inquiry would violate the Amendment's instruction that we "preserve," i.e., neither expand nor contract, the constitutional right to a jury trial. After all, there is little practical reason why a jury could not try many suits for injunctions.

The historical test established by the Seventh Amendment may be artificial from a functional point of view. But it satisfies the basic purpose of its drafters of safeguarding from erosion the right to jury trials which existed at the time of its adoption. Applying this test in this case we hold that a stockholders' derivative action is not a "suit at common law" to which the right to jury trial extends.

SMITH, *Circuit Judge* (dissenting):

I dissent. I would affirm the order denying the motion to strike the demand for jury trial. The underlying claim is essentially "a suit at common law," an action for a money judgment for unlawful conversion, breach of fiduciary duty, fraud and gross negligence. It would have been apt for jury consideration had the corporation itself sued. The issues are not so complex as to be beyond the competence of a trial jury. Cf. *Dairy Queen* v. *Wood*, 369 U. S. 469, 479 (1962). The fact that historically it was necessary for the shareholder to resort to equity in order to step into the corporation's shoes (*Cohen* v. *Beneficial Industrial Loan Corp.*, 337 U. S. 541, 548 (1949)), should no longer bar jury trial of the corporate claim. The reason for the denial of jury is eliminated through the provision by the federal rules of one civil action in which the issues of the right of the shareholder to sue and of violation of fiduciary duty causing damage to the corporation may "be tried side by side or otherwise as may be convenient; that one may go to the jury while the other does not causes no difficulty," *Fanchon & Marco* v. *Paramount Pictures*, 202 F. 2d 731, 735 (2d Cir. 1953). I would agree with the result reached by the Ninth Circuit in *DePinto* v. *Provident Security Life Ins. Co.*, 323 F. 2d 826 (9 Cir. 1963), cert. denied 376 U. S. 950, rehearing denied 383 U. S. 973.

Judgment of the Court of Appeals

UNITED STATES COURT OF APPEALS

FOR THE

SECOND CIRCUIT

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Courthouse in the City of New York, on the first day of November one thousand nine hundred and sixty-eight.

Present:

HON. J. EDWARD LUMBARD,
Chief Judge,

" J. JOSEPH SMITH,
" ROBERT P. ANDERSON,
Circuit Judges.

HOWARD ROSS and BERNARD ROSS, as Trustees for LENA ROSENBAUM,

Plaintiffs-Appellees,

v.

ROBERT A. BERNHARD, et. al.,

Defendants-Appellants.

Judgment of the Court of Appeals

Appeal from the United States District Court for the Southern District of New York.

This cause came on to be heard on the transcript of record from the United States District Court for the Southern District of New York, and was argued by counsel.

On Consideration Whereof, it is now hereby ordered, adjudged, and decreed that the order of said District Court be and it hereby is reversed and that the action be and it hereby is remanded for further proceedings in accordance with the opinion of this court with costs to be taxed against the appellees.

A true copy.

A. Daniel Fusaro

Clerk